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SUBJECT: The Japan Economic Scope--December 21, 2007

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INTERNATIONAL ASSISTANCE

13. (U) Japan to Provide Humanitarian Protection Assistance in Chad

Japan will grant some \$2.2 million to launch the Chadian Police for Humanitarian Protection (PTPH) according to a MOFA official. The monies will be used to provide facilities and equipment for a PTPH headquarters in N'Djamena and an academy to train Chadian police.

Once trained, personnel will protect refugees in eastern Chad under the supervision of UN police officers. UNSC resolution 1778 endorses the concept of the PTPH as part of multidimensional peacekeeping efforts in Chad and the Central African Republic (ECON: Sally Behrhorst/Eriko Marks)

14. (U) Japan Increases Donation to International Development

Japan will donate \$3.2 billion to the International Development Association (IDA) over a three-year period, according to a December 14 MOF press release. This represents a 30 percent increase over current levels. Japan's total share of IDA funding will nevertheless drop to 10 percent from the present 12.2 percent.

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The IDA had asked the GOJ for \$4.0 billion, but the government demurred citing fiscal constraints. According to the IDA, 45 nations, including six first-time donors, pledged a record \$25.1 billion to the World Bank affiliate to help fight poverty over the upcoming three-year term. (ECON: Sally Behrhorst)

TAXATION

15. (U) Ruling Parties Announce Limited FY 08 Tax Proposals

The ruling coalition--the Liberal Democratic and New Komeito parties--announced its FY08 tax reform proposals on December 13. The package calls for extending the present provisional cuts in the tax rates on both capital gains from share sales and limited dividend income for another two years. The coalition parties also proposed measures to narrow tax revenue disparities between local governments, and extend surcharge rates on road-related taxes for ten years.

As widely anticipated, the coalition party proposals represent only minor changes in Japan's tax system. The proposals do not call for an imminent hike in the consumption tax from the present five percent, or a cut in the effective income tax rate for companies from the current 40 percent. The proposed tax changes are estimated to result in a net tax cut of six billion yen (\$54.5 million) in combined national and local tax revenues once fully in place.

The Cabinet is set to approve the outline of legislation to implement the coalition's proposed tax changes around December 19. However, it is uncertain whether the government-proposed tax bills will become law in a timely fashion without amendment, due to the present Diet situation in which the opposition has a majority in the Upper House. Please see the attachment for more information. (FINATT: Shuya Sakurai/Maureen Grewe)

16. (SBU) Aichi Asked to Give Up 40 Billion Yen of Corporate Tax Revenue

Aichi prefecture is, not surprisingly, unhappy with the ruling coalition taxation committee's December 13 proposal to transfer a portion of its corporate tax revenue to help decrease regional economic disparity. Aichi has been asked to give up about 40 billion yen (approx. \$354 million). In 2006 Aichi's corporate tax revenues totaled about 487 billion yen (approx. \$4.3 billion), of which some 20 percent came from Toyota and its affiliated companies.

Although the amount Aichi is asked to give up was reduced to half of the 80 billion yen originally suggested by the committee, Aichi continues to negotiate to minimize the amount it will give up and/or to get corresponding compensation from the central government in other areas -- for example, GOJ support to build a second runway at Nagoya's Centrair International Airport. Aichi Prefecture Financial Section staff told us on December 18 that, among other complaints, they feel the proposal goes against the government's decentralization policy in that it takes back funds from a prefecture to redistribute according to central government priorities.

The Metropolitan Tokyo Government has reached a separate agreement with the central government on returning some of its tax revenues. Osaka is reportedly the only other prefecture on the hit list. (Nagoya: Tamiki Mizuno)

MEDICAL ISSUES

17. (U) CPRR Backs Down on Medical Mixed Treatments

The Council for the Promotion of Regulatory Reform (CPRR) will not include a recommendation to fully lift restrictions on mixed medical treatments (kongo shinryo) in its interim report, according to Japanese press reports.

Under the current system, patients bear the entire cost of medical treatment if a portion of that treatment is not covered by Japan's national health insurance. The Tokyo District Court

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ruled this policy illegal on November 7.

The CPRR has long supported kongo shinryo but backed down on calling for the lifting of restrictions in the face of fierce opposition from the Ministry of Health, Labor and Welfare (MHLW) and others.

Some media reports claim the final decision was left to PM Fukuda who demurred citing the issue's complexity. The lack of Kantei support could be further evidence of the CPRR's waning influence. (ECON: Sally Behrhorst)

PLANES AND TRAINS

18. (U) International Airfare Liberalization in Japan?

On December 5, Japan's Fair Trade Commission (FTC) formally requested the transportation ministry, MLIT, to review the current Aviation Law which exempts price cartels by the International Air Transport Association (IATA) from antitrust law, saying there is no rationale to maintain the current practice.

FTC issued same request in 1999, but MLIT rejected the request at that time arguing other countries practices are in line with Japan's on IATA pricing laws. However, this time FTC says there is no rationale for continuing the practice as active movements are taking place to abandon IATA cartels in the EU, U.S., and Australia.

According to Sankei Shinbun, IATA fares are applied to all

first-class tickets and 90 percent of business-class tickets for flights in and out of Japan.

MLIT's Vice Minister Minehisa as well as the Director-General of the Civil Aviation Bureau said they will thoroughly study the matter and will not rush to any conclusion. However, comments from MLIT officials indicate they believe the current system is working fine and a decision by Japan to abolish the current system might invite confusion in Asia's aviation market. (ECON: Junko Nagahama)

19. (SBU) Kitakyushu Airport to Expand Cargo Services

Galaxy Airlines, a new Tokyo-based cargo airline, announced December 14 plans to begin regular service (six roundtrips weekly) between Kitakyushu and Kansai International Airport (KIX) starting December 21. The decision was based on the success of the firm's Kitakyushu-Haneda operations, which began in October 2006. The airline delivered 4,800 tons of cargo over the past year, most home delivery services and mail-order sales. Galaxy expects similar demand for the Kitakyushu-KIX services.

Kitakyushu Airport began operations in March 2006 and its future course is unclear until the long-standing debate over whether to build a new airport for Fukuoka is settled. The president of Kitakyushu Air Terminal told post that, for Kitakyushu Airport to achieve long-term success, it must 1) expand its cargo services by taking advantage of the airport's 24-hour operations, and 2) cultivate niche markets untapped by Fukuoka Airport. In an effort to promote Kitakyushu's cargo business, Fukuoka Governor Wataru Aso recently told the prefectural assembly he welcomed the August 2007 Japan-Korea Aviation Agreement and would work to cultivate the Kitakyushu-Korea cargo market. (Fukuoka: Yuko Nagatomo/James Crow)

110. (U) Japan Central Rail Touts Eco-Friendly Trains

With Lord Nicholas Stern as a keynote speaker, Japan Central Railway--together with the Institute for Transportation Policy Studies--held a day-long symposium December 14 on climate change and the transport strategy. The symposium looked at what actions Japan can take and the benefits of rail over other forms of transportation, particularly air, in terms of lowering greenhouse gases (GHG).

Lord Stern, currently professor at the London School of Economics, stressed the importance of cost effectiveness in reducing GHG. To date many policies chosen have been high cost,

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but without correspondingly high effectiveness. Policies such as maintaining correct tire inflation and eco-driving can have strong, positive impacts. Other key points made at the conference include encouraging policy makers in the EU, US, China, and India as well as in Japan to look at rail as a means of moving people and goods with lower per-mile emissions, particularly if nuclear power is used to generate the electricity to run the trains.

A number of the speakers participated in the next day's inaugural meeting of a Japanese committee to study transportation and the global environment. The group will report its findings in about a year. (ECON: Robert Cekuta/Keiko Kandachi)

INVESTMENT ISSUES AND CORPORATE CONCERNS

111. (U) Lawyers More Cautious than Execs on Invoking Defensive Measures

According to a Nikkei survey, lawyers and company executives have differing views of the necessary procedures to invoke defensive measures against hostile takeover bids. 35.3 percent

of responding lawyers said a shareholders' resolution is necessary to activate the measures, while only 11 percent of executives agreed. An August Supreme Court decision in the Bull-Dog Sauce case that confirmed the legality of that company's poison pill defensive measure - in large part because the company had won shareholder approval - seems to have influenced the thinking of the lawyers. 62.8 percent of corporate respondents, meanwhile, said the decision could be made by a third-party committee or board of directors.

Similarly, 39.3 percent of lawyers said it is necessary to give financial compensation to the acquirer when invoking defensive measures, while only 12.8 percent of company officials thought likewise. (ECON: Satoshi Hattori)

¶12. (SBU) Citigroup Completes First Cross-border "Triangular" Stock Deal

Nikko-Cordial Corporation shareholders at a December 19 extraordinary general meeting approved Citigroup's plans to acquire the remaining 23 percent of the troubled brokerage in a cross border stock deal. This will be the first use of the triangular transaction provisions of Japan's new Company Law, which took effect May 1. The deal is technically not a triangular "merger" since Nikko Cordial will continue to exist as a separate 100 percent-owned subsidiary of the U.S. financial giant.

Nikko's remaining 31,000 shareholders will receive Citigroup shares in place of their current Nikko-Cordial stock. NikkoCitigroup equity analyst Tsutomu Fujita recently told the Embassy Citigroup could have used cash to complete the transaction, as it did in acquiring its initial 68 percent share of the company in a February tender offer. However, since Citigroup relisted its shares on the Tokyo Stock Exchange in June 2007, it wanted to use this deal, in part, to expand its Japanese shareholder base. (ECON: David DiGiovanna)

¶13. (U) BOJ "Tankan" Survey: Deterioration in Large Firms' Business Sentiment

The Bank of Japan's quarterly "tankan" survey of business sentiment, a closely watched business cycle indicator and a principal input in the central bank's monetary policy deliberations, reported a notable deterioration in business sentiment among large firms, largely reflecting concerns about high crude oil prices and volatile financial markets. The survey's "headline" business sentiment diffusion index (DI) for large manufacturers was well below market expectations. The survey revealed mixed sentiment among small and medium-sized firms. The survey also reported an upward revision of capital spending plans for all sizes of firms, and a slight tightening of labor market conditions. The BOJ Policy Board will hold its first post-"tankan" meeting on December 19/20. Many market observers are expecting the BOJ to maintain the present monetary policy stance for the time being. See attached paper for details. (FINATT: Shuya Sakurai)

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¶14. (U) Eco Products Trade Show Hit Record High Number of Visitors

Due to emerging consumer interest in choosing environmental-friendly commodities, the "Eco Products 2007" trade show in Tokyo saw the largest number of visitors (164,903 persons) since the annual event began in 1999. According to the Nihon Keizai Shimbun newspaper (Nikkei), a co-organizer of the show along with the Japan Environmental Management Association for Industry (JEMAI), about half the visitors were consumers and the rest came for business purposes. On December 15, the final day of the three-day occurrence, PM Fukuda attended the show.

Among the 632 exhibitors, Japanese automobile manufacturers attracted particular attention. Honda showcased a concept fuel cell car, which the company plans to lease to a limited number

of clients beginning late 2008. Nissan displayed an array of technologies to help reach its goal of reducing CO2 emissions of its fleet by approximately 70 percent from its 2000 level by 2050. The Narita International Airport publicized its "eco-airport" initiatives, such as reusing restaurant-emitting water for toilets in terminals, and composting garbage for flower gardens.

At a side event held by the Ministry of the Environment, Dr. Mitsumasa Okada, professor of green process engineering at Hiroshima University, stressed that Japan should introduce stricter environmental regulations in response to the rising public ecological awareness. (ECON: Keiko Kandachi)

ENERGY

¶15. (U) No Oil Refinery Project in Libya

On December 14, Nikkei reported five Japanese companies will build an oil refinery in Libya at a cost of nearly 500 billion yen. However, at a press conference later that morning, Economy, Trade and Industry Minister Amari denied the report. "The deal did not come through because Libya does not allow Japanese companies to be involved in upstream development rights. Japanese companies were only asked to invest in a refinery, which was not very profitable," he said.

Koji Yamaguchi of IPEX Corporation, one of Japan's leading oil developers and reported investor in the Libyan refinery project, confirmed Minister Amari's statement. The project is currently on hold and there is no prospect of restarting the negotiations, Yamaguchi stated. He said he was surprised by the news report, as were the other four companies cited in the article. In fact, the project was only in its infancy and had not even undergone a feasibility study, he added. Company representatives wondered where Nikkei had gotten its information, particularly with regards to the reported 500 billion yen price tag. "The deal has been standing still since February or March, and why this news report appears now on the front page of Nikkei is a mystery," Yamaguchi marveled. (ECON: Eriko Marks)

¶16. (U) Iraq to Purchase Electrical Transformers from Toyoda Tsusho

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Japanese trading house Toyoda Tsusho Corporation announced on December 6 it has received an order for 30 electrical transformers and peripheral devices from Iraq's Electricity Ministry. The contract is valued at approximately 4.4 billion yen (\$ 38.9 million). The project will replace old, deteriorated transformers with new ones in order to ensure a stable supply of electricity in and around Baghdad.

The project also includes training for Iraqi engineers who will maintain the transformers. According to Mr. Yusuke Chino of Toyoda Tsusho's public relations office, the training will be done in Japan, as the security situation in Iraq will not allow company personnel to travel to Baghdad. (ECON: Eriko Marks)

REFORMING REGULATIONS

¶17. (SBU) TSE's Saito Calls for Better Corporate Governance,

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Oversight

Tokyo Stock Exchange (TSE) President Atsushi Saito in a December 13 speech to the Foreign Correspondents Club of Japan said Japan had to address serious problems in its corporate governance if Tokyo is to become a leading global financial center. Saito, the former head of the Industrial

Reconstruction Corporation of Japan and, before that, a senior executive with Nomura Securities, has long been a voice for liberalization of Japan's financial markets and a critic of the closed nature of Japan's business elites.

In his FCCJ remarks, Saito called on government agencies such as the FSA to do more to police abuses by Japanese corporate boards that put shareholders interests below those of other "stakeholders." He was especially critical of the use of private placement of shares to third parties and cross-shareholding by Japanese firms as defenses against unwanted takeover bids.

Unfortunately, Saito was pessimistic about the ability of the TSE, as a quasi-private corporation, to effectively address the

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problem. Unless there is criminal activity, he said, "the most (the TSE) can do is issue a warning." This contrasts with the views of other observers, such as Pension Fund Association Executive Director Tomomi Yano, who told us recently he believes the best way to force changes in Japan's corporate governance include requiring more independent directors on Japanese corporate boards through stronger TSE rules.

Although, international outlets such as The Wall Street Journal and the Financial Times covered Saito's remarks, there was no coverage in the leading Japanese dailies. (ECON: David DiGiovanna)

¶18. (SBU) Insurance Advocacy Pays Off for U.S. Companies

Over the past several months, U.S. insurers have struck deals to market products through Japan's extensive postal network, taking advantage of Japan Post's privatization. They are also poised to capitalize on deregulation measures, set to go into effect December 22, which will allow banks to sell a full range of insurance products. One U.S. industry official estimated liberalization of bank sales alone will generate hundreds of millions of dollars in revenue for U.S. companies. The U.S. government has been working closely with U.S. industry in a multi-year push for these opportunities. Please see the attached cable for details. (ECON: Marc Dillard)

ECONOMIC IMPACT

¶19. Economic Policy Under a Divided Diet

The ruling Liberal Democratic Party's loss in July 2007's Upper House election resulted in a divided Diet and legislative gridlock, which has undercut economic reform advocates and pushed economic policymaking away from the prime minister's office. The result is a tougher environment for regulatory reform. Please see the attached cable for details. (ECON: Marc Dillard)

¶20. (U) FSA Measures Good Start to Improved Financial Market Competitiveness

On December 14, Financial Services Minister Watanabe submitted to the Council on Economic and Fiscal Policy a one-page rough outline of the Financial Supervision Agency's (FSA) plan for enhancing the competitiveness of Japan's financial and capital markets.

The plan consists of measures in four areas: (1) Creation of energetic and reliable markets; (2) Improvement of systems to promote various and advanced financial services; (3) Building a better regulatory environment; and (4) Improvement of the circumstances surrounding markets (see attachment for the listing of measures in each area). A more fully fleshed out report will be released by FSA next week.

The response of foreign financial firms has been generally positive, particularly for proposals to ease firewall restrictions on sharing information and staff among affiliated

entities.

The outline provides no indication of the timing of implementation of the recommended measures. A number of the proposals would require legislation, which makes the timing of implementation uncertain and opens up the possibilities of debate between the political parties. Please see the attachment for more information. (FINATT: Shuya Sakurai/Maureen Grewe)

¶21. (U) Hokkaido City Pleased With Economic Impact of Kitty Hawk Port Call

In early December, the Muroran Chamber of Commerce and Industry (CCI) released its official report on the economic impact of the October 26-30 port visit by the American aircraft carrier USS Kitty Hawk and the destroyer USS Fitzgerald. The Hokkaido port city estimates it received a \$2.9 million (323 million yen) economic boost from the visit. Sales of food, beverages and commodity goods generated by 5,800 sailors on the two ships and by 23,300 visitors during two days of public visitation accounted for \$1.15 million (126 million yen) of the total. Port-related revenues came to about \$1 million (110 million yen). Benefits realized by Muroran's service sector (bus, taxi, gasoline stations, etc.) also topped \$790,000 (87 million yen). Furthermore, the Muroran CCI says there were other positive spill-over effects difficult to calculate at this time.

Muroran officials decided early on that a visit by U.S. Navy ships was an opportunity to promote local businesses. They worked closely with ConGen Sapporo and the Navy to help make businesses more accessible to visiting sailors. During the visit, Muroran-based media also highlighted the economic boost experienced during the port call by publishing interviews with several happy business owners. (Sapporo: Ian Hillman/Yumi Baba)

SPORTS

¶22. (U) Dodgers Sign Kuroda to Three-Year Deal

The Los Angeles Dodgers scored the biggest prize of the current crop of Japanese baseball transplants with the December 15 signing of right-hander Hiroki Kuroda to a three-year, \$35.2 million deal. Kuroda, an 11-year veteran of the beloved but basement-dwelling Hiroshima Carp, is a multi-year All-Star in Japan with an overall 103-89 record and career 3.69 ERA. Combined with closer Takashi Saito, Kuroda should provide a powerful boost to the Dodger pitching staff similar to what the Matsuzaka-Okajima pairing did for Boston last year. With new manager Joe Torre at the helm, the Dodgers have to be considered a strong favorite to take the NL West Division next year. (ECON: David DiGiovanna)

¶23. (SBU) THIS WEEK'S CABLES

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¶24. (U) This SENSITIVE BUT UNCLASSIFIED e-newsletter from U.S. Embassy Tokyo's Economic Section, with contributions from the consulates, is for internal USG use only. Please do not forward in whole or in part outside of the government. The Scope is edited this week by Charlotte Crouch

(CrouchCA@state.gov) and Joy Progar (ProgarJ@state.gov).
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